IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

No. 3 (C.)

WRIGHT CONTRACTING COMPANY, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

SCOTT P. CRAMPTON
RICHARD S. DOYLE
Washington, D. C.
Attorneys For Petitioner

J. Q. DAVIDSON
TOM B. SLADE
Columbus, Georgia
Of Counsel

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

INDEX

	Page
Opinions Below	1
Jurisdiction	2
Questions Presented	2
Statutes Involved	2
Statement of the Case	2
Reasons for Granting the Writ	8
Argument	9
Conclusion	12
Appendix A	1a
Appendix B	2a

TABLE OF CASES

American Can Co. v. *Commissioner*, 317 F. 2d 604	11
Beacon Publishing Co. v. *Commissioner*, 218 F. 2d 697	9, 11
Commissioner v. *Cleveland Trinidad Paving Co.*, 62 F. 2d 85	11
Commissioner v. *Hansen*, 360 U. S. 446	10
Commissioner v. *O. Liquidating Corp.*, 292 F. 2d 225	11
Consolidated-Hammer Dry Plate & Film Co. v. *Commissioner*, 7 Cir., decided May 21, 1963, 63-1 USTC ¶ 9494	8, 10
Crosley Corp. v. *United States*, 229 F. 2d 376	9, 11
Daley v. *United States*, 139 F. Supp. 376, aff'd 243 F. 2d 466	11
Dally, Charles F., 20 T. C. 894	11
Guarantee Title & Trust Co. v. *Commissioner*, 313 F. 2d 225	10
Heinz, H. J. Co. v. *Granger*, W.D. Pa., 147 F. Supp. 664	11

Page

Lord v. *United States*, 296 F.2d 333 ..... 9, 11
Marquardt Corporation, 39 T.C. No. 42 10
Schlude v. *Commissioner*, 372 U. S. 128 ..... 8, 9
United States v. *Consolidated Edison Co. of N. Y.*, 366 U. S. 380 ..... 8, 9
United States v. *Harmon*, 205 F. 2d 919 ..... 8, 10

STATUTES

Internal Revenue Code of 1939:

Section 41 ..... 2, 1a
Section 42(a) 2, 1a

Internal Revenue Code of 1954:

Section 446(e) 12
Section 481(a)(2) 12
Section 6213 3
Section 7442 3
Section 7482 3
Section 7483 3

28 USC 1254(1) 2

MISCELLANEOUS

Guthner, "What Constitutes a Change in Method of Accounting?" 39 *Taxes* 514 (June 1961) 12
Hauser, "Significance and Implications of Some Recent Cases" 39 *Taxes* 965, 974-977 (Dec. 1961) 12
48 Virginia Law Review 731 (May 1962) 11

IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

No.

WRIGHT CONTRACTING COMPANY, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

The petitioner, Wright Contracting Company, prays that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 33-70a) are reported at 36 T. C. 620. The opinion of the Court of Appeals (Appendix B, *infra*, pp. 2a-12a) is reported at 316 F. 2d 249.

JURISDICTION

The judgment of the Court of Appeals was entered on April 19, 1963 (Appendix B, *infra*, p. 13a). A petition for rehearing was filed by the petitioner on May 9, 1963 (R. 150) which was denied on May 29, 1963 (Appendix B, *infra*, p. 14a). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Where a taxpayer-contractor, who keeps its books on the accrual basis, performs work on construction contracts which provide for the retention of a portion of the contract price pending final acceptance of the work, does the retained portion of the contract price constitute income which should be accrued by the taxpayer-contractor prior to such final acceptance when the acceptance, for the first time, entitled the taxpayer to payment and fixes the amount?

2. Does the fact that the taxpayer, in previous years, had erroneously accrued as income the amount of such retainages, prior to final acceptance of the work under the contract, prevent the taxpayer from correctly accruing the income as of the dates of final acceptance in the instant case?

STATUTES INVOLVED

The statutes involved are §§ 41 and 42 (a) of the Internal Revenue Code of 1939, and they are set forth in Appendix A, *infra*, p. 1a.

STATEMENT OF THE CASE

The petitioner is a corporation with its principal office at Columbus, Georgia. Its income tax returns for the taxable years involved herein were filed with

the collector or director of internal revenue for the district of Georgia. (R. 37) The jurisdiction of the Tax Court was invoked under §§ 6213 and 7442 of the Internal Revenue Code of 1954. (R. 12) The jurisdiction of the Court of Appeals was invoked under §§ 7482 and 7483 of said Code. (R. 123-128)

The petitioner is engaged in the general contracting business in which it has many long-term contracts. It keeps its books and files its tax returns on the accrual basis of accounting for the fiscal years ending June 30. (R. 37)

On March 14, 1955, petitioner filed claims (Form 843) for refund for the fiscal years ended June 30, 1951 and 1952, stating that for those years its returns treated amounts of retained percentages on contracts as income in the years in which the work was performed and that the claims for refund treated such retainage as income in the year in which the work was finished and finally accepted by the contracting authority. (R. 37)

In carrying on its general contracting business, petitioner's principal line of work is on highways, streets, sewer lines, airports, grading, drainage, and paving. In such work petitioner moves earth, makes fills, grubs trees, and lays asphalt and concrete. Petitioner contracts for work primarily in the various southeastern states. It generally has from 30 to 40 different jobs within a year and several jobs in process at the same time. (R. 38)

Many of the long-term contracts under which the petitioner was engaged during the years involved

provided that as the work progressed the petitioner was to be paid at certain times for the work actually done and based on the contract unit prices and, further, that out of such progress payments a certain percentage could be retained by the party for whom the work was done until the completion and final acceptance of the entire work covered by the contract. The "retainage" was withheld from amounts due petitioner for work performed in order to insure the proper performance and completion of the contract in accordance with prescribed standards. (R. 38-39)

The following provision is representative of a provision found in the long-term contracts under which petitioner performed work for various subdivisions and agencies of the United States Government. (R. 39-40)

> 7. PAYMENTS TO CONTRACTORS. — (a) Unless otherwise provided in the specifications, progress payments will be made as the work progresses at the end of each calendar month, or as soon thereafter as practicable, or at more frequent intervals as determined by the contracting officer, on estimates approved by the contracting officer. In preparing estimates the material delivered on the site and preparatory work done may be taken into consideration.
>
> (b) In making such progress payments there shall be retained 10 per cent on the estimated amount until final completion and acceptance of all work covered by the contract: Provided, however, That the contracting officer, at any time after 50 per cent of the work has been completed, if he finds that satisfactory progress is being made, may make any of the remaining progress payments in full: And provided further, That on

completion and acceptance of each separate building, vessel, public work, or other division of the contract, on which the price is stated separately in the contract, payment may be made in full, including retained percentages thereon, less authorized deductions.

(c) All material and work covered by progress payments made shall thereupon become the sole property of the Government, but this provision shall not be construed as relieving the contractor from the sole responsibility for all materials and work upon which payments have been made or the restoration of any damaged work, or as a waiver of the right of the Government to require the fulfillment of all of the terms of the contract.

(d) Upon completion and acceptance of all work required hereunder, the amount due the contractor under this contract will be paid upon the presentation of a properly executed and duly certified voucher therefor, after the contractor shall have furnished the Government with a release, if required, of all claims against the Government arising under and by virtue of this contract, other than such claims, if any, as may be specifically excepted by the contractor from the operation of the release in stated amounts to be set forth therein. If the contractor's claim to amounts payable under the contract has been assigned under the Assignment of Claims Act of 1940, 54 Stat. 1029 (41 U.S.C. Sec. 15), a release may also be required of the assignee at the option of the contracting officer.

The petitioner's contracts with various state governments and subdivisions thereof and with cities and municipalities contained provisions essentially similar to those quoted above providing for the contracting

governmental body to withhold a percentage of work progress payments until completion and final acceptance of the entire work covered by the contract. (R. 40).

The petitioner had amounts of "retainage" on long-term contracts at the end of each of the fiscal years ended June 30, 1945, to June 30, 1954, inclusive, as follows (R. 41):

Fiscal Year Ended June 30	Amount of "Retainage"
1945	$ 163,871.74
1946	151,963.69
1947	268,822.38
1948	213,783.89
1949	255,040.56
1950	244,557.72
1951	516,319.91
1952	612,130.63
1953	535,742.91
1954	1,066,951.18

The petitioner, from its incorporation through the fiscal year ended June 30, 1954, kept its books on the accrual basis and accrued on its books and records the amounts retained from earnings on long-term contracts as income in the year the work was performed. Petitioner deducted its overhead expenses and direct expenses in connection with its long-term contracts as the expenses accrued. It treated the retained amounts as accounts receivable at their face value and any retainage petitioner failed to collect was charged off. The same firm of certified public accountants has prepared petitioner's income tax returns since its incorporation in 1942, and in connection therewith has

made an annual audit of petitioner's books since about 1945 or 1946. (R. 37, 41)[1]

On its Federal tax returns from incorporation in 1942 through its fiscal year ended June 30, 1953, the petitioner reported amounts retained from earnings on long-term contracts as income in the year the work was performed. Further, petitioner's income tax returns for years prior to and including the fiscal year ended June 30, 1950, were closed on that same basis of accounting. (R. 42)

On its tax return for the fiscal year ended June 30, 1954, the petitioner did not report amounts retained during that year from its earnings on long-term contracts for work performed during the year. The petitioner has never received permission from the Commissioner of Internal Revenue to change its method of reporting income from long-term contracts. (R. 42)

In the statutory notice of deficiency and with respect to the fiscal years ended June 30, 1951, 1952, 1953, the Commissioner of Internal Revenue determined petitioner's tax liability on the basis of including in income the retainage on long-term contracts in the year the work was performed, i.e., the same basis as petitioner reported. With respect to the fiscal year

[1] The Tax Court at this point included as a part of its findings a statement to the effect that petitioner's system of accounting when consistently followed accurately reflected its income. (R. 41) It is submitted that such a statement is a conclusion of law. The petitioner assigned as an error the early accrual of its retainage (R. 127), and it obviously objects to the Court's inclusion in its findings of a conclusion which is not warranted by the findings of basic facts not consistent with the Court's statement in its opinion that it might "grant the propriety of the change." (R. 6)

ended June 30, 1954, he increased petitioner's reported gross income by including the amount of $531,208.25 as representing the difference between the $1,066,951.18 retainage at the end of the year over the amount of retainage at the beginning of the year. He determined that such amount of retainage on work performed in that year was properly includible in income of petitioner on the accrual basis. He further determined that petitioner should continue to use the method of reporting which it had consistently used on its books for all years and also on its tax returns for taxable years prior to the fiscal year ended June 30, 1954. (R. 42)

The parties herein are agreed that the above-mentioned amounts of retainage at the end of the fiscal years ended June 30, 1945, to June 30, 1953, inclusive, and $908,489.06 of the amount of retainage at June 30, 1954, were on various contracts as to each of which the entire contract had not been finally accepted at the end of those years, respectively. (R. 43)

REASONS FOR GRANTING THE WRIT

1. The decision below, in holding that the "retainage" was taxable income prior to acceptance of the work, presents a clear conflict with *United States v. Harmon*, 10 Cir., 205 F. 2d 919 (1953), and with *Consolidated-Hammer Dry Plate & Film Co. v. Commissioner*, 7 Cir., decided May 21, 1963, 63-1 USTC ¶9494, and is at variance with the holdings of this Court in *United States v. Consolidated Edison Co. of N. Y.*, 366 U.S. 380, 384-385 (1961), and *Schlude v. Commissioner*, 372 U.S. 128 (decided February 18, 1963).

2. The decision of the Court of Appeals, in holding that a taxpayer is not entitled as a matter of right to

correct an error, presents a clear conflict with *Beacon Publishing Co.* v. *Commissioner*, 10 Cir., 218 F. 2d 697 (1955); *Crosley Corp.* v. *United States*, 6 Cir., 229 F. 2d 376 (1956); and *Lord* v. *United States*, 9 Cir., 296 F. 2d 233 (1962).

3. In view of the complexity of the Federal taxing statutes and the frequent need of taxpayers to correct errors in their tax returns, it is submitted that the decision below involves an important question of Federal law which has not been, but should be, settled by this Court.

ARGUMENT

The threshold question in all of these accounting cases is when does an item of income accrue for Federal income tax purposes. The undisputed facts in this case show that as to the "retainage" here involved the petitioner, under its contracts, had no *right* to the withheld amounts prior to the "final completion and acceptance of all work covered by the contract." (R. 39)

Petitioner accordingly contends that as a matter of law the withheld "retainage" was not income to it in the years involved. This position is in accord with *United States* v. *Consolidated Edison Co. of N. Y.*, 366 U. S. 380, 385 (1961), where it was noted that—

> "* * * neither the Government nor an accrual-basis taxpayer may cause an item to be deducted in a year other than the one in which it accrued."

The same holding is implicit as to items of income. As was said in *Schlude* v. *Commissioner*, 372 U. S. 128, 137 (1963)—

> * * * For an accrual basis taxpayer "it is the *right* to receive and not the actual receipt that determines the inclusion of the amount in gross income," * * * [Italics by the Court; citations omitted][1]

The effect of the opinion below is to hold that items not legally income can be taxed as income because of an erroneous method of accounting. A comparable situation was considered in *Consolidated-Hammer Dry Plate & Film Company* v. *Commissioner*, 7 Cir., decided May 21, 1963, 63-1 USTC ¶9494, where the Internal Revenue Service sought to tax as income certain "partial payments" made to a Government contractor prior to acceptance of the work. In holding that such amounts were not taxable income the Seventh Circuit said:

> It is our conclusion that the partial payments were reportable as accrued income for income tax purposes only when delivery *and acceptance* of the products were made. (Italics supplied.)

In reaching this conclusion the Seventh Circuit cited with approval *United States* v. *Harmon*, 10 Cir., 205 F. 2d 919 (1953), on which petitioner has relied (R. 60; Appendix B, *infra*, p. 10a) and *Marquardt Corporation*, 39 T.C. No. 42, where the Tax Court expressly stated that it would not follow its holding

[1] One of the citations here was *Commissioner* v. *Hansen*, 360 U.S. 446, relied on by the Court below (Appendix B, *infra*, p. 11a). Petitioner submits that the *Hansen* case is readily distinguishable since it involved a completed sale with funds held in escrow merely to assure payment, while in the case at bar there was no completed transaction but only a partial performance. A similar distinction was noted in *Guarantee Title & Trust Co.* v. *Commissioner*, 6 Cir., 313 F. 2d 225, 228 (1963).

in the present proceeding but would adopt henceforth the contrary views expressed by it in *American Can Co.*, 35 T.C. 198, reversed 2 Cir., 317 F. 2d 604, 606 (1963).[2]

On the question of the right of taxpayers to correct errors, the conflict among the Circuit Courts seems crystal clear. The Sixth,[3] Ninth,[4] and Tenth[5] Circuits have held that taxpayers unquestionably have this right. The Second,[6] Third[7] and Fifth (Appendix B, *infra*, pp. 11a-12a) Circuits have held that they do not.

The Chief Counsel of the Internal Revenue Service has noted that the line between a "change in method of accounting" and the "correction of an error" is difficult to draw and is a bothersome problem to tax-

[2] The *Harmon* case is believed to represent the clear weight of authority on this point. *Daley v. United States*, N.D. Calif., 139 F. Supp. 376 (1956), affirmed 9 Cir., 243 F. 2d 466, 476, certiorari denied 355 U.S. 832; *Commissioner v. Cleveland Trinidad Paving Co.*, 6 Cir., 62 F. 2d 85, 86 (1932); *Charles F. Dolly*, 20 T.C. 894 (1953), affirmed on other issues, 9 Cir., 227 F. 2d 724, certiorari denied 351 U.S. 908; and *H. J. Heinz Co. v. Granger*, W.D. Pa., 147 F. Supp. 664, 673 (1956). See generally: Note 48 Va. L. Rev. 721, 733-734 (May 1962).

[3] *Crosley Corp. v. United States*, 6 Cir., 229 F. 2d 376, 379 (1956) which overruled a determination by the trial court that the "correction" amounted to a change in the method of accounting. *Crosley Corp. v. United States*, S.D. Ohio, 48 AFTR 1622.

[4] *Lord v. United States*, 9 Cir., 296 F. 2d 333, 335 (1962).

[5] *Beacon Publishing Co. v. Commissioner*, 10 Cir., 218 F. 2d 697, 702 (1955).

[6] *American Can Co. v. Commissioner*, 2 Cir., 317 F. 2d 604, 606 (1963).

[7] *Commissioner v. O. Liquidating Corp.*, 3 Cir., 292 F. 2d 225, 231 (1961), certiorari denied 368 U.S. 898.

payers and tax administrators.[8] Other writers have shared this view.[9]

While the present case arises under the provisions of the 1939 Code, the problem exists with comparable vigor under the provisions of §§ 446(e) and 481 (a)(2) of the Internal Revenue Code of 1954. The difficulties in this field are continuing and the problem needs a solution by this Court.

CONCLUSION

There is a direct conflict of decisions which require resolution by this Court. The issues concern basic principles and are of great importance in the administration of the tax law. The petition for certiorari should accordingly be granted.

Respectfully submitted.

SCOTT P. CRAMPTON
RICHARD S. DOYLE
Washington, D. C.
Attorneys for Petitioner

J. Q. DAVIDSON
TOM B. SLADE
Columbus, Georgia
Of Counsel

July, 1963

[8] Hauser, "Significance and Implications of Some Recent Cases," 39 Taxes 965, 974-977 (December, 1961).

[9] Guthner, "What Constitutes a Change in Method of Accounting?" 39 Taxes 514 (June, 1961). There are a series of comments on this area in 15 Journal of Taxation 194-207, 216-219 (October, 1961).